



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

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513.00-00

LEGEND:

M =
R =
City =
X =

Dear _____:

This is in response to your ruling request dated July 24, 2007 regarding a series of rulings in connection with distributions of a grant to a foreign government with respect to a project to fund infrastructure design, repair, construction, reconstruction, and improvement of public schools, roads and city streets.

You state that M is an organization that is tax-exempt within the meaning of section 501(c)(3) of the Internal Revenue Code ("Code") and is classified as a private foundation under section 509(a). Pursuant to M's Articles of Incorporation it is organized exclusively for charitable or educational purposes within the meaning of section 501(c)(3).

R is a country that has experienced considerable economic deterioration where a significant percentage of the population is impoverished. As such, R has scarce resources for restoring infrastructure.

M proposes three charitable projects. The first project is to renovate public schools ("School Project"). M intends to make disbursements of a grant to the Government of R which grant is to be used for the exclusive, charitable purpose of financing the design, construction, reconstruction and improvement of public schools in varying stages of disrepair located in City and various outlying areas in R. The School Project funds will be used to rehabilitate the

physical structures of certain schools and build new additions to other schools that require expanded facilities. The schools are owned by the Government of R and are governed through the regional governing bodies. The School Project agreement requires that the Government of R conduct educational activities in these buildings supported by a regular faculty and curriculum with a regular enrolled student body of pupils or students in attendance. The agreement also requires that the Government of R make the schools available to the general public free of charge for at least twenty (20) years after the completion of the school restoration. The agreement provides that the government cannot sell, lease or otherwise transfer or change the primary use of any school property for at least the same twenty (20) year period. The Government of R has adopted and is required to use in good faith policies prohibiting discrimination based on color, national or ethnic origin in all aspects of the operations of the schools and shall make this policy known to the public. Records are required to be maintained to demonstrate compliance with these agreements including statistical records of the racial compositions of the student body to evidence this non-discrimination policy.

The remaining two charitable projects are to distribute funds to the Government of R, one to provide funding for the financing, construction and improvement of public roads ("Road Project") and the other to provide the financing, construction and improvement of City streets ("Street Project"). M plans to make disbursements of a grant to the Government of R to be used for the exclusive, charitable purpose of financing the design, construction, reconstruction and improvement of portions of a public road network in R. The grant funds are to be used to rehabilitate portions of the existing road network in varying stages of disrepair thereby assisting public transport, supporting the supply of goods and services in impoverished areas and benefiting the citizens of R. The agreement has identified certain public roads that are owned and maintained by the Government of R. The Government of R agrees to make the roads available to the general public free of charge for at least ten (10) years from the date the work is completed.

The Street Project involves rehabilitating portions of the streets in disrepair in City. Similar to the Road Project, M makes disbursements of a grant to the Government of R which is required to be used for the exclusive, charitable purpose of financing the design, construction, reconstruction and improvement (including the removal of railway lines) of a public street network in City. The street is owned by the municipality of City and is used by the general public. The agreement for this project requires that the Government of R to agree that the streets will be available to the general public free of charge for at least ten (10) years from the date the work is completed.

The agreements are binding international agreements and are designed to fund and monitor grant-related expenses such as the reporting, documentation and supervision requirements of the grants.

Specifically, the grant agreements provide specific prohibitions on the use of funds for any other purpose, including:

- (1) Funding, producing or distributing weapons (including chemical and biological weapons), items of mass destruction, other goods intended for use in warfare or terrorism or illegal drugs;
- (2) Engaging in, financing or otherwise providing material support for acts of war or terrorism or illegal drug trade;
- (3) Carrying on propaganda, or otherwise attempting to influence the outcome of any specific local, provincial or Government body, entity or authority;
- (4) Influencing the outcome of any specific local, provincial or Government public election, or carrying on, directly or indirectly, any voter registration drive with respect to any such election; or political campaigns, lobbying or influencing legislation or voters;
- (5) Making grants to individuals for travel or study, or to any charitable organization that is not or is not treated as public charity for purposes of the Code; or
- (6) Purchasing any X goods or services.

The Government of R has also agreed not to use any of the funds provided by M, directly or indirectly, to purchase goods that have been produced, manufactured, extracted or processed by any country subject to U.S. embargo or sanctions. Lastly, the grant agreements also prohibit any disqualified person (as defined in section 4946 of the Code) from receiving grant funds, whether as grants or compensation for services. Specifically, M has represented that no disqualified persons will be involved in or benefit from the financing, construction, including being the recipients of any construction projects, or improvement of the schools, roads and/or streets pursuant to the above projects.

The Government of R is required to use the international procurement practices and procedures and the guidelines of standard bidding and internationally accepted contract forms of the World Bank to secure services, good and materials. All such contracts are furnished to M for review prior to the authorization by the Government of R of such contract, to ensure that the terms of the grant agreement are met.

For each project, the Government of R must substantiate that it has obtained services or that supplies have been purchased for which it seeks reimbursement. Invoices and evidence of payment must be provided to M. In addition, the Government of R must demonstrate that all other terms and conditions of the agreement governing the project have been met. The use of grant funds by the government is restricted to charitable use.

All work performed must meet or exceed the construction codes of R in effect during the construction. There must be an on-site supervisor for each construction site, hired using the competitive bidding procedures and guidelines based on the standards set by the World Bank. Grant amounts are subject to stated monthly limits and overall aggregate limitations. The Government of R must provide M with a monthly progress report including a comparison on the actual costs to the estimated budget. If the Government of R exceeds the budgeted amounts, R is required to pay any differences. In addition, if any expenses are below the monthly limit, the excess cannot be used for any other expense and its availability lapses. R is required to provide documentation of the payment of the expenses it incurs. The required documentation includes any and all invoices, salary payment records or information, bank statements detailing the payments made, and any information necessary to describe any assets or supplies acquired.

All documentation must be provided to M and determined by M to be in compliance with the terms and conditions of the grant agreements. M has the ability to unilaterally terminate the agreement for any reason including lack of performance or diversion or misuse of funds. Any grant funds remaining in the accounts after the completion of the project must be repaid to M.

M will monitor through extensive supervision and documentation, the flow of funds for its charitable projects. Funds transferred electronically must be maintained in segregated accounts owned by the Government of R and dedicated to the projects. Any disbursements pursuant to the grant agreements are made for work performed and supplies obtained. Supporting documentation and certification are obtained post-disbursement. Any advance payment requested must detail the use of the funds and documentation evidencing the expenditures must be provided to M. As information is received, M conducts an inquiry to ensure that there is no duplication of funding requests.

The Project Manager and the other administrative staff members of M provide administrative services to implement and monitor the grants provided to the Government of R. These persons monitor the progress of the projects and ensure that all documentation and other necessary paperwork are in proper order. The staff visits the project sites to ensure compliance with the terms and conditions of the grant agreements and to facilitate information regarding the projects.

In addition to the other controls, each grant agreement contains a compliance plan and procedures to comply with U.S. laws to prevent the support of terrorist activities.

RULINGS REQUESTED

M has requested the following rulings:

1. The grant is for exclusively charitable, program-related activities for purposes of the Code because they will be used exclusively in the impoverished country of R to create essential public works for the general public of R and will combat community deterioration.
2. The funds disbursed pursuant to the grant agreements will not cause the imposition of any of the private foundation excise taxes, and specifically:
 - A. The tax on net investment income under section 4940 does not apply to the return to M of its previously awarded grant funds because such funds represent a nontaxable repayment of principal rather than net investment income. In the event that M acquires ownership of the Accounts, any interest earned or currency exchange gain or losses produced after M acquires ownership will need to be included by M under section 4940 as items in its calculation of net investment income.
 - B. The Government of R is unrelated to M, and the funds disbursed pursuant to the grant agreements to the Government of R will not create any self-dealing pursuant to section 4941, and furthermore there is no indirect act of self-dealing under the facts described;

- C. The funds disbursed pursuant to the grant agreements are qualifying distributions for purposes of meeting the minimum qualifying distribution amount under section 4942;
 - D. The funds disbursed pursuant to the grant agreements do not create any "business holdings" within the meaning of section 4943;
 - E. The funds disbursed pursuant to the grant agreements do not create any jeopardizing investments within the meaning of section 4944;
 - F. The funds provided pursuant to the grant agreements are for exclusively charitable purposes and are not taxable expenditures pursuant to, and are not subject to the expenditure responsibility rules of, section 4945 because the Grants are made to the Government of R and the Government will make no secondary grants of the funds, but only payments of compensation for goods and services received;
3. The grant agreements will not give rise to unrelated business taxable income under sections 511-513 of the Code; and
 4. The payments to the Project Manager are fees for personal services rendered in connection with M's program related charitable activities, and are qualifying distributions made in furtherance of M's exempt purposes, as compensation and not "grants."

LAW

Sections 170(c)(2)(B) and 501(c)(3) of the Code both refer to organizations organized and operated exclusively for charitable purposes.

Section 511 of the Code imposes a tax on the unrelated business taxable income of exempt organizations.

Section 512 of the Code defines "unrelated business taxable income" as gross income derived from any unrelated trade or business regularly carried on by it, less certain deductions and modifications.

Section 513(a) of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purpose or function.

Section 513(c) of the Code provides that "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

Section 4940 of the Code imposes an excise tax on the net investment income of a private foundation.

Section 4941 of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1) of the Code defines self-dealing as any direct or indirect:

- (A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;
- (B) lending of money or other extension of credit between a private foundation and a disqualified person;
- (C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;
- (D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;
- (E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.
- (F) agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than certain employment agreements.

Section 4941(d)(2)(D) of the Code provides that the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such furnishing is made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public.

Section 4942 of the Code imposes an excise tax on a private foundation's undistributed income, defined as its distributable amount less qualifying distributions.

Section 4942(g)(1)(A) of the Code defines a "qualifying distribution" as including any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than certain contributions to organizations controlled by the foundation or by disqualified persons or to private non-operating foundations.

Section 4943 of the Code imposes an excise tax on the excess holdings by a private foundation in business enterprises.

Section 4944 of the Code imposes an excise tax on a private foundation's making of an investment in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4944(c) of the Code provides that an investment is not jeopardizing if its primary purpose is to accomplish 170(c)(2)(B) purposes and no significant purpose is the production of income or the appreciation of property.

Section 4945 of the Code imposes an excise tax on each taxable expenditure of a private foundation.

Section 4945(d) of the Code defines a "taxable expenditure" by a private foundation as an amount paid or incurred:

- (1) to attempt to influence legislation,

- (2) to influence a specific public election or carry on a voter registration drive,
- (3) to grant funds to an individual for travel, study, or similar purposes unless certain requirements are met,
- (4) to grant funds to an organization unless it is described in sections 509(a)(1), (2), or (3) or 4940(d)(2) or unless the private foundation exercises expenditure responsibility with respect to the grant in accordance with section 4945(h), or
- (5) for a non-170(c)(2)(B) purpose.

Section 4946 of the Code defines "disqualified persons" with respect to a private foundation as substantial contributors, foundation managers, 20% owners of a substantial contributor, family members of an individual who is one of the above, entities 35% owned by one of the above, and certain government officials.

Section 4946(c) of the Code, defines for purposes of section 4941 the term "government official" means, with respect to an act of self-dealing described in section 4941, an individual who, at the time of such act, holds any of the following offices or positions (other than as a "special Government employee", as defined in section 202(a) of title 18, United States Code):

4946(c)(1) an elective public office in the executive or legislative branch of the Government of the United States,

4946(c)(2) an office in the executive or judicial branch of the Government of the United States, appointment to which was made by the President,

4946(c)(3) a position in the executive, legislative, or judicial branch of the Government of the United States--

4946(c)(3)(A) which is listed in schedule C of rule VI of the Civil Service Rules, or

4946(c)(3)(B) the compensation for which is equal to or greater than the lowest rate of basic pay for the Senior Executive Service under section 5382 of title 5, United States Code,

4946(c)(4) a position under the House of Representatives or the Senate of the United States held by an individual receiving gross compensation at an annual rate of \$15,000 or more,

4946(c)(5) an elective or appointive public office in the executive, legislative, or judicial branch of the government of a State, possession of the United States, or political subdivision or other area of any of the foregoing, or of the District of Columbia, held by an individual receiving gross compensation at an annual rate of \$20,000 or more,

4946(c)(6) a position as personal or executive assistant or secretary to any of the foregoing, or

4946(c)(7) a member of the Internal Revenue Service Oversight Board.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations ("regulations") provides that the term "charitable" includes relief of the poor and distressed or of the underprivileged; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to combat community

deterioration.

Section 1.513-1(b) of the regulations provides that for purposes of section 513 of the Code the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 53.4941(d)-3(b)(1) of the Foundation and Similar Excise Taxes Regulations ("foundation regulations") provides generally that under section 4941(d)(2)(D) of the Code, the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such goods, services, or facilities are made available to the general public on at least as favorable a basis as they are made available to the disqualified person, so long as such goods, services, or facilities are functionally related to the exercise or performance by a private foundation of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(c)(3).

Section 53.4941(d)-3(b)(2) of the foundation regulations provides that for purposes of this paragraph, the term "general public" shall include those persons who, because of the particular nature of the activities of the private foundation, would be reasonably expected to utilize such goods, services, or facilities. This paragraph shall not apply, however, unless there are a substantial number of persons other than disqualified persons who are actually utilizing such goods, services, or facilities. Thus, a private foundation which furnishes recreational or park facilities to the general public may furnish such facilities to a disqualified person provided they are furnished to him on a basis which is not more favorable than that on which they are furnished to the general public.

Section 53.4942(a)-3(a)(2) of the foundation regulations defines a "qualifying distribution" as including any amount (including program-related investments and reasonable and necessary administrative expenses) paid to accomplish section 170(c)(2)(B) of the Code purposes, other than certain contributions to organizations controlled by the foundation or one or more disqualified persons or to non-operating private foundations.

Section 53.4943-10(b) of the foundation regulations provides that business holdings do not include program-related investments.

Section 53.4944-3(a)(1) of the foundation regulations defines a "program-related investment" as an investment which possesses the following characteristics:

- (i) its primary purpose is to accomplish section 170(c)(2)(B) of the Code purposes;
- (ii) no significant purpose is the production of income or the appreciation of property;
- and
- (iii) no purpose is to accomplish section 170(c)(2)(D) of the Code purposes.

Section 53.4945-2(a)(5)(i) of the foundation regulations provides that a grant by a private foundation to an organization described in section 509(a)(1), (2) or (3) of the Code does not constitute a taxable expenditure by the foundation under section 4945(d), other than under section 4945(d)(1), if the grant by the private foundation is not earmarked to be used for any activity described in section 4945(d)(2) or (5), is not earmarked to be used in a manner which would violate section 4945(d)(3) or (4), and there does not exist an agreement, oral or written, whereby the grantor foundation may cause the grantee to engage in any such prohibited activity

or to select the recipient to which the grant is to be devoted. For purposes of this paragraph (a)(5)(i), a grant by a private foundation is earmarked if the grant is given pursuant to an agreement, oral or written, that the grant will be used for specific purposes.

Section 53.4945-2(a)(5)(ii) of the foundation regulations provides that for purposes of section 53.4945-2, an organization shall be considered a section 509(a)(1) of the Code organization if it is treated as such under section 53.4945-5(a)(4) of the regulations.

Section 53.4945-2(a)(6)(ii) of the foundation regulations provides that a grant by a private foundation to fund a specific project of a public charity is not a taxable expenditure by the foundation under section 4945(d)(1) of the Code to the extent that:

- (A) The grant is not earmarked, within the meaning of section 53.4945-2(a)(5)(i) of the regulations, to be used in an attempt to influence legislation, and
- (B) The amount of the grant, together with other grants by the same private foundation for the same project for the same year, does not exceed the amount budgeted, for the year of the grant, by the grantee organization for activities of the project that are not attempts to influence legislation. If the grant is for more than one year, the preceding sentence applies to each year of the grant with the amount of the grant measured by the amount actually disbursed by the private foundation in each year or divided equally between years, at the option of the private foundation. The same method of measuring the annual amount must be used in all years of a grant. This paragraph (a)(6)(ii) applies without regard to whether the public charity has made the election under section 501(h).

Section 53.4945-2(a)(6)(iii) of the foundation regulations provides that for purposes of determining the amount budgeted by a prospective grantee for specific project activities that are not attempts to influence legislation under section 53.4945-2(a)(6)(ii), a private foundation may rely on budget documents or other sufficient evidence supplied by the grantee organization (such as a signed statement by an authorized officer, director or trustee of such grantee organization) showing the proposed budget of the specific project, unless the private foundation doubts or, in light of all the facts and circumstances, reasonably should doubt the accuracy or reliability of the documents.

Section 53.4945-4(a)(2) of the foundation regulations provides that, for purposes of section 4945 of the Code, the term "grants" shall include, but is not limited to, such expenditures as scholarships, fellowships, internships, prizes, and awards. Grants shall also include loans for purposes described in section 170(c)(2)(B) and "program related investments" (such as investments in small businesses in central cities or in businesses which assist in neighborhood renovation). Similarly, "grants" include such expenditures as payments to exempt organizations to be used in furtherance of such recipient organizations' exempt purposes whether or not such payments are solicited by such recipient organizations. Conversely, "grants" do not ordinarily include salaries or other compensation to employees. For example, "grants" do not ordinarily include educational payments to employees which are includible in the employees' incomes pursuant to section 61. In addition, "grants" do not ordinarily include payments (including salaries, consultants' fees and reimbursement for travel expenses such as transportation, board, and lodging) to persons (regardless of whether such persons are individuals) for personal services in assisting a foundation in planning, evaluating or developing projects or areas of program activity by consulting, advising, or participating in conferences organized by

the foundation.

Section 53.4945-4(a)(4)(ii) of the foundation regulations provides that a grant by a private foundation to an organization described in section 509(a)(1), (2), or (3) of the Code, which the grantee organization uses to make payments to an individual for purposes described in section 4945(d)(3), shall not be regarded as a grant by the private foundation to the individual grantee (regardless of the application of section 53.4945-4(a)(4)(i) of the regulations) if the grant is made for a project which is to be undertaken under the supervision of the section 509(a)(1), (2), or (3) organization and such grantee organization controls the selection of the individual grantee. This rule shall apply regardless of whether the name of the individual grantee was first proposed by the private foundation, but only if there is an objective manifestation of the section 509(a), (1), (2), or (3) organization's control over the selection process, although the selection need not be made completely independently of the private foundation. For purposes of this rule, an organization shall be considered a section 509(a)(1) organization if it is treated as such under section 53.4945-5(a)(4).

Section 53.4945-5(a)(2) of the foundation regulations cross-references section 53.4945-4(a) for the definition of grants for purposes of section 4945(d)(4) of the Code.

Section 53.4945-5(a)(4)(iii) of the foundation regulations provides that a foreign government (or agency or instrumentality) is treated as a section 509(a)(1) of the Code organization for purposes of section 53.4945-5 even if it is not described in section 501(c)(3). However, a grant to any such organization must be made exclusively for 170(c)(2)(B) purposes.

Section 53.4945-5(a)(6)(i) of the foundation regulations provides that a grant by a private foundation to a grantee organization which the grantee organization uses to make payments to another organization (the secondary grantee) shall not be regarded as a grant by the private foundation to the secondary grantee if the foundation does not earmark the use of the grant for any named secondary grantee and there does not exist an agreement, oral or written, whereby such grantor foundation may cause the selection of the secondary grantee by the organization to which it has given the grant. For such purpose, a grant described herein shall not be regarded as a grant by the foundation to the secondary grantee even though such foundation has reason to believe that certain organizations would derive benefits from such grant so long as the original grantee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of the private foundation.

Section 53.4945-5(b)(3) of the foundation regulations provides that, except as provided in subparagraph (4) of this paragraph, in order to meet the expenditure responsibility requirements of section 4945(h), a private foundation must require that each grant to an organization, with respect to which expenditure responsibility must be exercised under this section, be made subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization. Such commitment must include an agreement by the grantee--

- (i) To repay any portion of the amount granted which is not used for the purposes of the grant,
- (ii) To submit full and complete annual reports on the manner in which the funds are spent and the progress made in accomplishing the purposes of the grant, except as provided in paragraph (c)(2) of this section,
- (iii) To maintain records of receipts and expenditures and to make its books and records

available to the grantor at reasonable times, and

(iv) Not to use any of the funds--

(a) To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)),

(b) To influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of section 4945(d)(2)),

(c) To make any grant which does not comply with the requirements of section 4945(d)(3) or (4), or

(d) To undertake any activity for any purpose other than one specified in section 170(c)(2)(B).

The agreement must also clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, for the purchase of capital equipment, or for general support provided that neither the grants nor the income therefrom may be used for purposes other than those described in section 170(c)(2)(B).

Rev. Rul. 71-29, 1971-1 C.B. 150, held that a grant by a section 501(c)(3) of the Code organization to a city transit authority for the purpose of maintaining a mass transportation system qualified as a charitable disbursement in furtherance of the grantor's exempt purpose. The Service stated that the charitable element in facilitating public transportation is established in the Statute of Charitable Uses, 43 Eliz. I, c.4 (1601), which recognized as charitable the "repair of bridges, ports, havens, causeways ... and highways."

Rev. Rul. 71-460, 1971-2 C.B. 231, held that a section 501(c)(3) of the Code organization may conduct part or all of its charitable activities in a foreign country.

Rev. Rul. 74-125, 1974-1 C.B. 327, held that a private foundation's payments to consultants were not grants under section 4945(d)(3) of the Code. The foundation's activities included disseminating publications and developing and conducting training programs to assist educators in using improved educational methods. The consultants' services included the development of model curricula in a particular educational area and the design of materials to assist educators in the performance of their educational functions. The Service reasoned that the consultants' services were personal services assisting the foundation in planning and developing its projects under section 53.4945-4(a)(2) of the regulations.

Rev. Rul. 76-459, 1976-2 C.B. 369, held that the use of a private foundation museum's private road for access to the adjacent headquarters and manufacturing plant of a corporation (disqualified person) during the same hours the road is used by the general public as a thoroughfare connecting two public streets was not an act of self-dealing under section 4941 of the Code.

ANALYSIS

Ruling 1.

Domestic corporations exempt from taxation under section 501(c)(3) of the Code may conduct all or part of their charitable activities in a foreign country. Activities that are charitable within the meaning of section 501(c)(3) when carried on within the United States may be carried on in a foreign country. The determination of whether an activity is charitable depends on the type of

activity conducted.

Based on the information submitted by M, the grants will be made exclusively for the charitable purpose under sections 501(c)(3) and 170(c)(2)(B) of the Code of erecting or maintaining public schools, building and maintaining public roads and facilitating public transportation. See Rev. Rul. 71-29 which provides that the charitable element of in facilitating public transportation is established in the Statute of Charitable Uses which recognized as charitable the repair of bridges and highways. Such activity also helps to alleviate distress in a poverty-stricken area and combat community deterioration. Moreover, M has taken reasonable steps to ensure that the grants will be used exclusively for the intended charitable purposes and not diverted for non-charitable purposes.

Ruling 2.A.

Section 4940 of the Code generally imposes a tax on the net investment income of a private foundation. Net investment income is the amount by which the sum of the gross investment income and the capital gain net income exceeds allowable deductions. See Section 4940(c). Gross investment income is the gross amount of income from interest, dividends, rents, payments with respect to securities loans (as defined in section 512(a)(5)), royalties and similar sources, but only including any such income that is taxed as unrelated business income under section 511. Capital gain net income includes gains and losses from the sale or other disposition of property used for the production of gross investment income. And property used for the production of income included in computing the tax imposed by section 511 (unless gain or loss from the sale or other disposition of such property is already taken into account for purpose of the tax under section 511) with certain modifications.

M intends to make one or more distributions of pursuant to the grant agreements. The Minister of Justice of R has opined that the Government of R owns the accounts under R law. M's right to acquire or transfer all or a portion of each account is permitted only to ensure compliance with the terms and conditions of the grant and compliance with U.S. laws. Thus, M has represented that any interest or earnings is the interest and earnings of R. If for any reason, the Government of R is required to return grant funds to M, such funds should be considered a return of principal provided that the amount of the funds are not in excess of the grant principal due to be returned to M. M has represented that the grant program as described will not generate any net income or capital gain for M. Therefore, a return to M of grant funds would not result in net investment income that would be taxable under section 4940 of the Code. However, when the funds are returned to M, any subsequent earnings on these funds would be subject to tax under section 4940.

Ruling 2.B.

Generally transactions between a disqualified person and a foundation are subject to the self-dealing rules set forth in section 4941 of the Code. Section 4941(d)(1) defines "self-dealing" to include "any direct or indirect . . . sale or exchange, or leasing, of property between a private foundation and a disqualified person." If the transaction described above were determined to be an act of self-dealing, it would subject the self-dealing persons to an excise tax on "each act of self-dealing between a disqualified person and a private foundation" pursuant to section 4941(a)(1). However, in order to apply section 4941 we must first determine if there are disqualified persons in the transaction with the private foundation.

Section 4946(a) defines a "disqualified person" to include substantial contributors to the foundation, a foundation manager (which includes directors and officers), owners of a certain percentage of the corporation's voting power, and any members of the family of any of the foregoing, and only for purposes of section 4941, a government official (as defined in section (c)). A government official is defined as 1) an elective public office in the executive or legislative branch of the Government of the United States, an office in the executive or judicial branch of the Government of the United States, appointment to which was made by the President, 3) a position in the executive, legislative, or judicial branch of the Government of the United States, (4) a position under the House of Representatives or the Senate of the United States held by an individual receiving gross compensation at an annual rate of \$15,000 or more, (5) an elective or appointive public office in the executive, legislative, or judicial branch of the government of a State, possession of the United States, or political subdivision or other area of any of the foregoing, or of the District of Columbia, held by an individual receiving gross compensation at an annual rate of \$20,000 or more, (6) a position as personal or executive assistant or secretary to any of the foregoing, or (7) a member of the Internal Revenue Service Oversight Board. M is planning to make distributions to the Government of R, and the Government of R is not considered to be a government official as defined above and therefore is not a disqualified person with respect to M. As such, the grants are not direct acts of self-dealing. Moreover, we find no indirect self-dealing under the facts described.

Ruling 2.C.

Amounts expended and property transferred by a private foundation to meet the mandatory payout requirement must be in the form of qualifying distributions. Pursuant to section 53.4942(a)-3(a)(2)(i) of the foundation regulations a "qualifying distribution" includes any amount (including program-related investments and reasonable and necessary administrative expenses) paid to accomplish one or more charitable purposes under section 170(c)(1) and (2)(B) of the Code other than certain contributions to organizations controlled by the foundation, and any amount paid to acquire an asset used directly in carrying out a charitable purpose within the meaning of section 501(c)(3).

Based on the above facts, we have determined that the distributions under the grant projects will be qualifying distributions by M under section 4942(g) of the Code. The information submitted indicates that the grants from M to the Government of R are intended to be used to accomplish one or more of the charitable purposes described in section 170(c) and are not contributions to a controlled organization or a private nonoperating foundation. That the charitable activity of M will be conducted in a foreign country does not change the fact that these grants are considered to be qualifying distributions. Rev. Rul. 71-460 specifically holds that an activity which is charitable within the meaning of section 501(c)(3) if carried on in the United States would also be charitable activity if carried on in a foreign country. Moreover, the information submitted indicates that M will have in place guidelines and measures which will allow M to be reasonably assured that the grants will be used by the Government of R for charitable purposes within the meaning of sections 501(c)(3) and 170(c).

Ruling 2.D.

Section 4943 of the Code generally provides that the combined "business holdings" of a private foundation and all disqualified persons in any corporation (or unincorporated business)

conducting a business which is not substantially related to the exempt purpose of the foundation are limited to 20% of the voting stock (or profits interest) in such corporation or business. The grant agreements provided by M restrict the use of the funds to the construction and improvement of infrastructure owned by the Government of R and to implementing expenses related to the infrastructure. M has represented and warranted that it, and its disqualified persons, has no ownership interest in this infrastructure and it has no stock interest or other interest in any business enterprises in R. M will not receive anything in return for its grants, including any kind of ownership interest in a business enterprise that would constitute a business holding under section 4943. Moreover, M's making of such grants is not itself a trade or business that would constitute a sole proprietorship of M or a joint venture with the Government of R.

Ruling 2.E.

Section 4944 of the Code provides that if a private foundation invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes, an excise tax is imposed on the making of such investment. Section 53.4944-1(a)(2) of the foundation regulations provides that the exempt purposes of a private foundation are considered jeopardized where the foundation managers, in making an investment, have failed to exercise ordinary business care and prudence in providing for the foundation's long term and short term financial needs as are necessary to carry out its exempt purposes. Here, M's grants, in which M does not expect to receive back any principal and will not in any event receive net income or gain, are not investments in the ordinary financial sense of the term. If the grants were considered investments under section 4944 of the Code, then they would constitute program-related investments.

Ruling 2.F.

Section 4945 of the Code imposes an excise tax on each taxable expenditure of a private foundation. A taxable expenditure is defined to include any amount paid or incurred by a private foundation:

- (1) to attempt to influence legislation,
- (2) to influence a specific public election or carry on a voter registration drive,
- (3) to grant funds to an individual for travel, study, or similar purposes unless certain requirements are met,
- (4) to grant funds to an organization unless it is described in sections 509(a)(1), (2), or (3) or 4940(d)(2) or unless the private foundation exercises expenditure responsibility with respect to the grant in accordance with section 4945(h), or
- (5) for a non-section 170(c)(2)(B) purpose.

Section 53.4945-5(a)(4)(iii) of the foundation regulations provides that grants to foreign governments may also be excepted from the expenditure responsibility rules. That section provides that a foreign government, any agency or instrumentality thereof, or an international organization designed by Executive Order under 22 U.S.C. 288 will be considered a section 509(a)(1) of the Code organization provided that the grant is made for exclusively charitable purposes as described in section 170(c)(2)(B). Because M's distributions are going to the Government of R, M does not need to exercise expenditure responsibility under section 4945(h)

with respect to such grants, because the Government of R is deemed a 509(a)(1) organization for such purposes.

Regarding earmarking, section 53.4945-5(a)(6) of the foundation regulations provides that a grant by a private foundation to a grantee organization which grantee organization uses to make payments to another organization (the secondary grantee) shall not be regarded as a grant by the private foundation to the secondary grantee if the foundation does not earmark the use of the grant or any named secondary grantee and there does not exist in agreement, oral or written, whereby such grantor foundation may cause the selection of the secondary grantee by the organization to which it has given the grant. M has represented that the Government of R will make no secondary grants of the funds, but only payments of compensation for goods and services received. Moreover, M's review and approval of contracts to ensure conformity with the terms of the grant agreements is not the equivalent of earmarking funds for such contractors.

Ruling 3.

Section 511 of the Code imposes a tax on the unrelated business income of organizations exempt from taxation under section 501(c)(3). Section 512 provides that unrelated business taxable income is gross income derived from any unrelated trade or business regularly carried on by it, less certain deductions and modifications. Section 513 defines an unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purpose or function. Section 513(c) provides that "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. Therefore, in determining whether an income-producing activity is an unrelated trade or business, it is necessary to show that (1) there is a trade or business, (2) the trade or business is regularly carried on, and (3) the conduct of the trade or business is not substantially related to the organization's exempt purpose or function. See section 1.513-1 (a) of the regulations. Here, M's grant activity is not a trade or business within the meaning of section 513, because there is no expectation of any profit (or even return of capital) from the activity. Thus, there is no production of income expected for M. If the activity were considered a trade or business and considered to be regularly carried on, then it would be a related trade or business, because it contributes importantly to the accomplishment of M's charitable purposes.

Ruling 4.

Section 53.4945-4(a)(2) of the foundation regulations provides that, for purposes of section 4945 of the Code, the term "grants" do not ordinarily include salaries or other compensation to employees. For example, "grants" do not ordinarily include educational payments to employees which are includible in the employees' incomes pursuant to section 61. In addition, "grants" do not ordinarily include payments (including salaries, consultants' fees and reimbursement for travel expenses such as transportation, board, and lodging) to persons (regardless of whether such persons are individuals) for personal services in assisting a foundation in planning, evaluating or developing projects or areas of program activity by consulting, advising, or participating in conferences organized by the foundation. Here, the services to be provided by the Project Manager are consulting services like those described in Rev. Rul. 74-125 to assist the foundation in planning and developing its projects. Thus, under sections 53.4945-4(a)(2)

and 5(a)(2), M's payments to the Project Manager in furtherance of M's exempt purposes, are treated as compensation and not grants.

RULING[S]

Based on the information submitted, we rule as follows:

1. The grants are for exclusively charitable, program-related activities for purposes of sections 501(c)(3) and 170(c)(2)(B) of the Code because they will be used exclusively in the impoverished country of R to create essential public works for the general public of R and will combat community deterioration.
2. The funds disbursed pursuant to the grants will not cause the imposition of any of the following private foundation excise taxes:
 - A. The tax on net investment income under section 4940 does not apply because if any funds disbursed pursuant to the grants are required to be repaid to M, such funds represent a repayment of principal not taxable under section 4940 rather than net investment income;
 - B. The Government of R is unrelated to M, and the funds disbursed pursuant to the grants to the Government of R will not create any self-dealing pursuant to section 4941, and there is no indirect act of self-dealing under the facts described;
 1. The funds disbursed pursuant to the grants are qualifying distributions for purposes of meeting the minimum qualifying distribution amount under section 4942;
 2. The funds disbursed pursuant to the grants do not create any "business holdings" within the meaning of section 4943;
 3. The funds disbursed pursuant to the grants do not create any jeopardizing investments within the meaning of section 4944;
 4. The funds provided pursuant to the grants are for exclusively charitable purposes and are not taxable expenditures pursuant to, and are not subject to the expenditure responsibility rules of, section 4945 because the grants are made to the Government of R and the Government will make no secondary grants of the funds, but only payments of compensation for goods and services received; and
3. The grants will not give rise to unrelated business taxable income under sections 511-513 of the Code.
4. The payments to the Project Manager are fees for personal services rendered in connection with M's program-related charitable activities are considered compensation and not "grants."

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

Because this letter could help resolve any future questions about tax consequences of your activities, you should keep a copy of this ruling in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney and Declaration of Representative currently on file with the Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure:
Notice 437